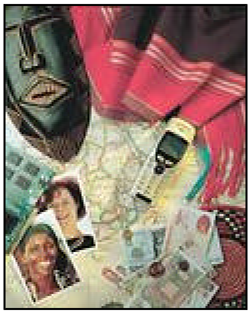

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Growth Strategy for North Africa: A Regional Approach

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Although the North African countries made significant progress toward achieving financial stability under IMF-supported programs during the mid-1980s and the 1990s, growth in these countries has remained below potential. Notwithstanding the considerable efforts they have expended on education, Algeria, Morocco, and even the more successful Tunisia have not performed as well as countries that have become integrated with the world economy. For instance, during 1970-99, the average annual growth rate of real per capita GDP was slightly negative in Algeria, 1.5 percent in Morocco, and 3.2 percent in Tunisia. As a result, unemployment has increased from an average of 12 percent in 1990 to 18.8 percent by 2000, ranging from about 15 percent in Tunisia to 30 percent in Algeria. Poverty is pervasive: in the 1990s, the incidence of poverty actually rose in Algeria and Morocco, while it stagnated in Tunisia.

There are a number of reasons for North Africa's lackluster growth, including the modest pace of structural reforms and weak macroeconomic policies, which led to balance of payments and debt problems for Morocco in the late 1980s and Algeria in the early 1990s. A major contributing factor has been the slow progress made by these countries in opening their economies to trade and investment. The North African economies continue to be hobbled by their narrow export base. Moreover, bilateral trade between them is limited and well below potential; it accounts for only a small fraction of each country's total trade.

Taken individually, the North African markets are small and highly protected. With respect to trade in goods, protectionism takes many forms, including high tariffs, valuation problems, nontariff barriers (such as standards and regulations), and physical barriers at the borders. Independent business surveys show that private investors generally feel that the business environment in the region has many serious problems, such as excessive red tape and weak domestic institutions—particularly the legal and judicial systems. As a result, foreign direct investment (apart from that associated with privatization) remains at low levels. However, there is a paradox in the sense that foreign investors, once established in the three countries, report favorably on working conditions there.

Persistence of the current inadequate growth performance of these countries could disrupt the delicate social balance they have achieved, with potential ripple effects on their neighbors, including the northern Mediterranean countries. This is particularly true because the populations of the Maghreb countries have been growing rapidly, despite a notable deceleration recently. As a result of the rapid population growth of the past, the labor force is growing by about 2.5 percent a year in Tunisia and a little more than 3 percent in Algeria and Morocco, another reason unemployment rates remain high.

There is, fortunately, a broad consensus among the Maghreb authorities on the need for faster growth to reduce unemployment, although there is less of a consensus on how to proceed. It should be noted, however, that, at present, conditions in North Africa are favorable: inflation is low in all three countries, their external reserve positions are comfortable, debt has been reduced to more acceptable levels, and substantial progress has been made with structural reforms (particularly privatization and price decontrol). What the countries need now is a reform strategy designed to improve resource allocation and create institutions suitable for accelerated growth. This strategy could be articulated around four pillars.

First pillar: maintaining sound macroeconomic policies to contain inflation and avoid a recurrence of balance of payments difficulties. Fortunately, there is broad agreement on this. Fiscal situations are basically sound and there is a consensus on the need for active monetary policy, more flexibility in exchange rate policy (although with important differences among countries), and market-based interest rates and price policies.

Second pillar: liberalization of domestic markets and increased openness. To increase competition and improve resource allocation, both the domestic market and the external sector need to be reformed further. There is considerable scope in each country for liberalizing the services sector (in particular, transportation, telecommunications, and the financial sector, which have a strong impact on production costs in other sectors), improving the legal and judicial systems, downsizing the public sector through privatization and civil service reforms, and streamlining bureaucracy. For instance, the civil service wage bills in these countries (at 10 percent or more of GDP) are far higher than those in most other countries at similar levels of development. These initiatives should be accompanied by trade liberalization (reduction of both tariffs and nontariff barriers), the streamlining of regulations governing foreign direct investment, and the adoption of measures designed to facilitate trade.

Third pillar: cooperation agreements with the European Union that offer the North African countries the opportunity and incentive to move forward with trade liberalization and industrial restructuring. There are essentially three ways of opening up the North African economies. The first is for each one to open up unilaterally. The second is a multilateral approach—liberalization under the aegis of the World Trade Organization, an option that would help avoid some distortions (such as trade diversion). The third is for countries to negotiate agreements with their largest trading partner—the European Union. Morocco and Tunisia have already signed agreements with the European Union, while EU negotiations with Algeria are ongoing.

This last approach has been chosen by the Maghreb countries as most appropriate in the short term because it provides them with a common framework for reform. For example, cooperation agreements with the European Union require domestic market reforms, such as harmonization of standards, rules, and regulatory frameworks. These reforms are needed to eliminate practices that distort trade, such as monopolies, government subsidies, and privileges granted to public enterprises. Thus, the EU arrangements will provide a strong impetus for the North African countries to move toward an open trade regime, with substantial benefits in terms of growth and investment, but these benefits will accrue over time and only if the major complementary reforms described in the first and second pillars are implemented. This "bilateral" approach should be seen as a catalytic first step, to be quickly followed by multilateral liberalization.

Fourth pillar: regional measures that complement cooperation agreements with the European Union. Although cooperation agreements with the European Union will undoubtedly provide the North African countries with many benefits, there may also be disadvantages—for example, it could prove to be more profitable for a foreign investor to set up a business in Europe that produces goods for export to individual North African countries than to invest directly in the region, and foreign direct investment flows could dry up. Liberalization of intraregional trade would help the North African countries avoid this pitfall by replacing small individual national markets with a much larger regional market of 70 million consumers. Liberalization would thus stimulate trade within North Africa, which is currently negligible; gravity models (models that link bilateral trade flows to the economic size of, and distance between, trading partners) show that bilateral trade between, for example, Algeria and its neighbors is substantially below its potential.

The North African countries could also seize the opportunity offered by their agreements with the European Union to deepen regional cooperation to their common benefit. For instance, they could exchange views on their respective reform programs, discuss common issues, such as the challenges inherent in the conclusion of such agreements, and share best practices, among other things. They could also consider coordinating their regulatory reforms, such as tax holidays and other incentives in their investment codes, and harmonize the regulation of services (such as telecommunications) to limit market fragmentation. This would pave the way for cooperation in other areas, such as regional transport and telecommunications, financial infrastructure (merging stock exchanges, for example), harmonization of property rights and investment law, adoption of common positions in trade negotiations, and efforts to obtain external financing for infrastructure development. While regional cooperation is not a substitute for sound macroeconomic policies or needed structural reforms, it would eliminate the market fragmentation that currently makes the region unattractive to investors, thereby allowing North Africa to unleash its formidable economic potential.

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